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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 968

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. .....

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

William C. Hay, formerly a naturalized citizen of the United States, but now a repatriated British subject, by his counsel, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered in the above cause on November 14, 1944, affirming a decision of the Tax Court of the United States.

Opinions Below.

The Tax Court's opinion [R. 53-76*] is reported at 2 T. C. 460. The opinion of the Circuit Court of Appeals [R. 374-384] is reported at 145 F. (2d) 1001.

*References such as this are to pages of the printed Transcript of Record. Italics supplied throughout unless otherwise indicated

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered November 14, 1944 [R. 385]. Petition for rehearing was denied January 3, 1945 [R. 415]. Jurisdiction is conferred on this Court under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

August 6, 1937, petitioner transferred all of the shares of a California corporation, costing $32,500, in exchange for all the shares of a Bahamas corporation, worth $2,491,583, without satisfying the Commissioner in the manner provided in Section 112(i) of the Revenue Act of 1936 [copied at R. 334].

December 10, 1937, the Bahamas Corporation surrendered all the shares of the California corporation in exchange for a general assignment of all of the latter's assets in complete liquidation.

Both exchanges took place in Nassau, where petitioner resided.

The questions presented are:

1. Whether Section 112(i) may be applied differently in the case of a nonresident alien than in the case of a citizen or resident alien. More specifically, the question is whether the gain on the August exchange, which would unquestionably be "recognized" *and taxed* to a citizen or resident alien, may be wholly disregarded and not "recognized" by the Commissioner or the courts in order to by-

pass and defeat Section 212(a), which prevents such gain from being taxed to a nonresident alien.*

2.** Whether gain on an exchange of stock for assets in complete liquidation is a "dividend" within the meaning of Section 119(a)(2), as the Circuit Court of Appeals held, or is gain from an "exchange" within the meaning of Section 119(a)(6), as petitioner contends.

3. Where the Commissioner determined and assessed the deficiency on the basis that petitioner was a citizen and was taxable on the August 6 gain, adhered to that position in his answer and throughout the trial, and twice expressly declined to amend his answer, was it due process of law for the Tax Court to sustain the deficiency upon the diametrically contradictory basis that petitioner realized gain on the December exchange and was taxable thereon as a nonresident alien engaged in business in the United States, the petitioner having prevailed on each of the three issues framed by the pleadings?

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*As shown by the 90-day letter [R. 8], elucidated by the 30-day letter [R. 11, 13, 15, 17, 18, 19—see reference to Sec. 112(i) on R. 19] and by the opinion of the Circuit Court of Appeals [R. 384], the Commissioner originally taxed the identical gain—on the August exchange—that he later sought to disregard if, but only if, the evidence showed that petitioner was a nonresident alien on August 6 and that the August exchange was consummated outside the United States. See also opinion of Tax Court rejecting the Commissioner's contention that the August exchange "should be regarded as having taken place in the United States * * *." [R. 67-68.]

**This question and question 3 disappear if Sec. 112(i) *requires* that the August 6 gain be "recognized." *Cf. Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913, at 918-919, squarely holding that Sec. 112(i) "cannot be ignored" by the Commissioner or the courts. This case was ignored by both courts below, although specifically called to their attention.

Statutes Involved.

The applicable statute is the Revenue Act of 1936, c. 690, 49 Stat. 1648. Most of the relevant sections of that Act were copied in Appendix A to respondent's brief in the Circuit Court of Appeals and may be found at R. 332-340. Others are copied in the Appendix, *infra*, pp. 21 to 23.

The applicable regulations are Regulations 94, some of the articles of which are copied at R. 340-349, others in the Appendix, *infra*, pp. 23 to 29.

Statement.*

This case involves income tax liability for the calendar year 1937. The pertinent findings are undisputed; the bulk of the printed record relates to the question of procedural due process.

Born a British subject in Canada, petitioner became a naturalized citizen of the United States in 1918. Exercising "a natural and inherent right of all people,"[1] petitioner expatriated himself on June 17, 1937, and simultaneously became repatriated as a British subject, entitled to the rights confirmed by the Naturalization Convention of 1870 between the United States and Great Britain,[2] and to the right to remove his property from the United States guaranteed by Article II of the Convention of 1899

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*No brief in support will be filed, but because of the length of both opinions below and the nature and importance of the several questions, this Statement will necessarily be somewhat extended (12 pages).

[1]See Sec. 800 of Title 8, U. S. C. A.—Right of Expatriation—copied in footnote 1 of opinion of Tax Court, R. 64; also at R. 331.

[2]16 Stat. 775, Malloy, Treaties, Conventions, etc. (1910), Vol. 1, pp. 691-693. Art. III provides that the United States will not claim a repatriated British subject "as a citizen of the United States on account of his former naturalization."

between the United States and Great Britain as to Tenure and Disposition of Real and Personal Property.[3]

More than ten years prior to 1937, petitioner acquired all the stock of William C. Hay, Ltd., a California corporation, at a cost of $32,500. Shortly after his repatriation in Canada on June 17, 1937, "petitioner proceeded to Los Angeles to wind up his *personal*[4] affairs, and, on July 21, 1937, he left Los Angeles for Nassau" [R. 57]. Arriving at Nassau July 26, 1937, with all the stock of Hay, Ltd. in his possession, petitioner immediately established residence there. August 4 a corporation named Colonial Trust Co., Ltd. was chartered under the laws of the Colony of the Bahamas and on August 6 all of the stock of Hay, Ltd. was transferred to Colonial in exchange for all its stock, which on that date had a value of $2,491,583 in United States dollars [R. 57-58].

Three months later, in November, petitioner became alarmed over the possibility that tax legislation would be enacted by Congress in 1938 aimed at surpluses of American corporations. [R. 59; *cf.* R. 66.] As a result, the Board of Directors of Hay, Ltd., meeting in Nassau on December 3, authorized the winding up and dissolution of that corporation and the distribution of its assets [R. 59]. This action was taken pursuant to a written consent executed by Colonial, as Hay, Ltd.'s stockholder [R. 59], under authority of Sec. 400 of the California Civil Code [copied at R. 104]. Under Sec. 400a [R. 105-106], the dissolution proceedings were subject to revocation *by Colonial* "at any time prior to distribution of the assets"

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[3]31 Stat. 1939, Malloy, Treaties, etc. (1910), Vol. 1, pp. 774-777.

[4]There is no finding of fact that petitioner engaged in trade or business or had an office or place of business in the United States during the taxable year *qua* nonresident alien; and such a finding, if made, would not be within the issues as framed by the pleadings [R. 1-4; R. 20].

by Hay, Ltd. Thus Hay, Ltd. retained the ownership of its assets until the very moment that, in Nassau on December 10 [R. 59], it executed and delivered the written assignment by which it "conveyed to Colonial * * * all its property" [R. 59-60]. Until that moment the dissolution proceedings created no tax consequences.[5] Under California law, "The assignment having been delivered in the [Colony of the Bahamas], the transaction took place in that State * * *."[6] Colonial still owned all these assets—and others—at the time of the hearing in 1942 [R. 60, 61].

Examining petitioner's 1937 tax return, the Commissioner determined that petitioner had realized a capital gain of $2,459,083 by reason of the August 6 exchange [R. 384]; that 30% of this amount was to be "taken into account" under Section 117 [R. 336]; and that there was a deficiency of $484,093.20 [R. 18-19]. This determination was necessarily bottomed on recognition by the Commissioner of the foreign corporation as an entity separate from petitioner, and necessarily excluded the idea of gain to petitioner *individually* from the December liquidation, from which he acquired exactly nothing. (There is no finding as to the value of the assets on December 10 and hence it cannot be determined whether *Colonial* realized gain or loss on *that* exchange.)

In his petition to the Tax Court [R. 1-5], petitioner did not challenge either the fact or amount of "recognized" gain but asserted that he was a nonresident alien on August 6, 1937; that the exchange of that date took place in Nassau; and that the profit constituted income from sources without the United States and could not,

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[5]*Cf. Wells Fargo Bank v. Blair*, 26 F. (2d) 532, 534 (C. A. D. C., 1928).

[6]*Balconades Ballroom, Inc. v. Superior Court*, 109 Cal. App. 612, 615 (1930) [R. 398, note 14].

therefore, be included in his gross income for the purpose of computation of his liability for United States income taxes [R. 384].

Respondent's answer [R. 20] put in issue petitioner's allegations that he was an alien, that he was a nonresident, and that the exchange of August 6 took place outside the United States. [The Tax Court eventually found in favor of petitioner on all three of these issues. R. 62; 66-67.] Neither the answer nor the deficiency notice made any claim that petitioner individually realized any gain from the liquidation of the California corporation in December.

Shortly before trial in 1942, the Commissioner made a jeopardy assessment of the deficiency, together with interest computed on the erroneous factual assumption that petitioner was a citizen, not a nonresident alien.[7] Throughout the entire trial [R. 142, 182, 211, 295], the Commissioner, consistently with the issues framed by the pleadings, contended that petitioner's "alleged expatriation" was fraudulent and that he was taxable—as a citizen unquestionably would be—on the undisputed gain of $2,459,083 realized from the exchange of August 6.

But while affirmatively declining [R. 168; 241] to amend his pleadings to frame a new issue, in the alternative or otherwise, the Commissioner *orally* contended, but only in the alternative, that petitioner individually realized a gain from the December 10 exchange, though concededly petitioner actually received no property whatever subsequent to August 6. This alternative was necessarily bottomed upon ignoring the Bahamas corporation as a separate entity and consequently excluded the idea that petitioner realized gain in August.

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[7]The Tax Court eventually gave petitioner judgment for $7,321.08, representing interest for the 92 days beginning March 15, 1938, for which a citizen or resident alien, but not a nonresident alien, would have been liable. [R. 79.]

Although this unpleaded alternative ground was diametrically contradictory of the basis of the Commissioner's deficiency determination, of the basis of the jeopardy assessment,[8] and of the Commissioner's position in his pleadings, the Tax Court, over petitioner's objections and in disregard of its own rules and decisions, permitted the Commissioner to pursue both contentions without amending his answer to set up the new matter.

The Tax Court found that petitioner "has been a nonresident alien of the United States at all times since June 17, 1937" [R. 62]. It held [R. 66-67] that—

> The gain on the original exchange of August 6, *viewed as a separate transaction,* would have been taxable to petitioner under the provisions of section 112(i) were it not for the fact that the exchange took place outside the United States * * * and is not taxable to petitioner, a nonresident alien. Sec. 212(a), *supra.* (Italics added.)

The Tax Court specifically rejected the Commissioner's argument that the August 6 "exchange should be regarded as having taken place in the United States" [R. 67].

But the Tax Court did not stop there, as it should have; it held, inconsistently, that petitioner realized "a large profit" from the December liquidation [R. 68] and that the "source" of this profit was within the United States [R. 73].

The decision thus comes down to this: Petitioner realized no gain on August 6, when he acquired new property worth $2,491,583 in exchange for property costing $32,500, but realized "a large profit" on a date on which he acquired no property whatever.

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[8]The Commissioner would not have assessed interest for the 92 days beginning March 15, 1938 [R. 63] unless he considered petitioner to be taxable as a citizen or resident alien.

The slightest analysis shows that this bizarre concept would not have been adopted had the Tax Court found that petitioner was a citizen on August 6, or that that exchange took place within the United States; that it was conceived and brought into being only as a way to defeat the mandate of Section 212(a), which is merely declaratory of the constitutional right of a nonresident alien to be free from tax on income from sources without the United States.

In *Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913 at 918-919, the Tax Court squarely held that Section 112(i) is not limited to citizens or residents. When that provision was first enacted (as Section 112(k) of the Act of 1932, 47 Stat. 169), there were substantial reasons why it should be applicable to nonresident aliens. All nonresident aliens were then liable for tax on all income from sources within the United States, including capital gains from sales or exchanges.[9] While Congress knew that a nonresident alien, by making an exchange of *personal* property with a foreign corporation outside the United States, could escape taxation on any gain therefrom, Section 119(a)(6), Congress doubtless also knew that Section 112(i) would result in a nonresident alien being taxable on "recognized" gain from an exchange of *real* property with a foreign corporation, as such a gain, under Section 119(a)(5) (*infra*, p. 21), is "income from sources within the United States" regardless of where the exchange takes place.

Sections 111, 112(a), 112(b)(5) and 112(i) draw no distinction whatever as between different classes of taxpayers and clearly should not be applied differently to a

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[9]It was not until the Act of 1936 that Congress provided that nonresident aliens not engaged in business and not having an office or place of business in the United States were to be taxed only on "fixed or determinable" income, which does not include capital gains.

nonresident alien than to a citizen or resident alien. It is only after the provisions of Sections 111 and 112 have first been applied to determine the realization and "recognition" of gain that it is permissible for the Commissioner or the courts to look to Sections 212(a) and 119 to determine whether the gain, though realized and "recognized," is includible in the gross income of a nonresident alien. The opinion of the Circuit Court of Appeals clearly shows that it violated this principle and thus wholly defeated the true import of Section 212(a).[10]

One of the reasons for filing this petition is the conviction that this Court will not permit an administrative official or the courts to ignore the unambiguous language of a specific statutory provision merely to defeat the rights of a friendly alien. Compare, by analogy to the by-passing herein of Section 212(a), *United States v. General Motors Corp.*, Jan. 8, 1945, 89 Law. Ed. Adv. Ops. 379 at 384.

The Solicitor General, with his usual candor, will doubtless concede that if a citizen or resident alien had made the August 6 exchange, and had died the very next day, he would be liable for tax on a "recognized" gain of $2,459,083 *even though the December exchange had never occurred.* This is so because, since Section 112(i) withdraws[11] nonrecognition of gain but preserves nonrecognition of loss, it necessarily applies to each exchange *separately* if there are two or more. If the August and December exchanges be viewed in combination, they would constitute a tax-free reorganization except for Section 112 (i). (*Cf. Whittell & Company, Inc.*, 34 B. T. A. 1070.) The Tax Court had no power to view the August

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[10]See especially the Court's footnote beginning R. 377, and particularly the last sentence thereof, R. 378.

[11]"Withdraws" is the terminology of Senate Rep. No. 655, 72nd Cong., 1st Sess. (1932 Act), 1939 Cum. Bull. (part 2), p. 515, copied in the Appendix, *infra*, p. 28.

and December exchanges otherwise than as separate transactions. As *Dobson v. Commissioner,* 320 U. S. 489, makes clear, "latitude" exists in the Tax Court in such matters only "Where no statute or regulation controls, * * *" (pp. 501-502). In the case at bar, Section 112(i) is a specific and controlling statute, and Article 112(i)-1 is a specific and controlling regulation. They broke up what in combination would have been a "reorganization" under Section 112(b)(3) and (g) [R. 333], and made two separate transactions, *each* of a taxable nature. This is nonetheless true where the taxpayer is a nonresident alien than where he is a citizen or resident alien.

Furthermore, there was gain on the August 6 exchange —realized that day—whether that exchange be viewed separately or not. Petitioner still owns the identical property he received August 6, and the December exchange neither added to, nor subtracted from, nor changed, that which petitioner got August 6.

The Circuit Court of Appeals introduced a new concept, namely, "that Hay made no *actual* profit from the exchange of August 6, 1937" [R. 378]. Obviously that fact—and the further fact, ignored below, that petitioner made "no actual profit" during 1937 at all—are utterly irrelevant under Sections 111 and 112. This is clearly shown by *Helvering v. Cement Investors, Inc.,* 316 U. S. 527, and particularly by a case cited with apparent approval in note 3 therein, *Insurance & Title Guarantee Co. v. Commissioner,* 36 F. (2d) 842 (C. C. A.-2, 1929).

Both courts below recognized that it was not enough merely to hold that petitioner realized a gain from the December liquidation exchange; there was no tax liability in any event if the "source" of that "gain" was outside the United States. Section 212(a). Under California law, which applies the *mobilia sequuntur* rule, the "source" would clearly be Nassau, not California. (*Robinson v.*

McColgan, 17 Cal. (2d) 423; *Miller v. McColgan,* 17 Cal. (2d) 432 (1941).) But the matter of "source" under the federal act is governed by the specific language of Section 119 [R. 336]. Two mutually exclusive subdivisions of that section are involved: Section 119(a)(2)—Dividends, and Section 119(a)(6)—Sale of Personal Property. By definition, Section 119(f) [R. 338], the word "sale" includes "exchange." Section 119(e) provides that "gain * * * derived from the purchase of *personal* property within and *its* sale without the United States * * *, shall be treated as derived entirely from sources within the country in which sold * * *" [R. 337].

The undisputed findings show that petitioner's foreign corporation, as the *owner* of the California shares, surrendered them *in Nassau* in exchange for a general assignment of assets executed by the California corporation in Nassau on December 10 [R. 59-60]. Under decisions construing Section 119, a sale or exchange takes place where title to the property passes. (*East Coast Oil Co.,* 31 B. T. A., 558, 561 (1934), affirmed, *Commissioner v. East Coast Oil Co.,* 85 F. (2d) 322 (C. C. A.-5, 1936), certiorari denied, 299 U. S. 608. *Cf. Compania General De Tabacos De Filipinas v. Collector,* 279 U. S. 306.)

There is a complete correlation between the *assessing* provisions of Section 211 [R. 338], the *withholding* provisions of Section 143(b) (*infra,* p. 22), and the *source* provisions of Section 119 [R. 336]. To say, as did the Circuit Court of Appeals [R. 382], that a distribution in liquidation is a "dividend" within Section 119(a)(2) is inescapably to say that it is a "dividend" within Section 211(a) [R. 338] and Section 115(a) [R. 334]. To say that it is a "dividend" within Section 211(a) is necessarily to say that it is a "dividend" within Section 143(b). To say that a distribution in liquidation is a "dividend" within Section 143(b) is to say that every corporation which makes a distribution in liquidation to a nonresident

alien, whether taxable under Section 211(a), or 211(b), must withhold the tax thereon.[12]

Yet we find that the Regulations have made it clear that a distribution in liquidation is not a "dividend" within the meaning of Sections 119(a)(2), 143(b) and 211(a); also that the term "dividends," as used in those sections, means precisely the same thing as "dividend" as defined in Section 115(a).

Art. 211-7(a) [R. 344] says: "As to the determination of fixed or determinable annual or periodical income see article 143-2. Art. 143-2 (*infra*, p. 26), defines "fixed or determinable annual or periodical income" as including "dividends," and Art. 143-1 (*infra*, p. 26), says: "For determining income from sources within the United States, see section 119." Art 119-3—Dividends, says: "Gross income from sources within the United States includes dividends, *as defined in section 115*" (*infra*, p. 24). The statutory definition of "dividend" is found in Section 115(a), and comparison with Section 115(c) shows clearly that a "dividend" does not include a distribution in liquidation. That is also the view of Art. 143-1 of the Regulations, which says:

> * * * The tax must be withheld at the source from the *gross* amount of any distribution made by a corporation *other than* * * * a distribution in partial or complete liquidation.

As a distribution in liquidation is not a "dividend" within Section 119(a)(2), it must necessarily involve an "exchange" within Section 119(a)(6). As the shares of Hay, Ltd., surrendered in exchange for that corporation's assets, were *personal* property, the source of the "gain," assuming there was any, was "the country in which sold." (Section 119(e).) The undisputed findings shows that this was in Nassau [R. 59-60].

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[12]See first sentence of Art. 143-1, Regs. 94, *infra*, p. 25.

Art. 143-2 also says that "The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income." This is extremely important, as nonresident aliens taxable under Section 211(a) are taxable *only* on "annual or periodical income"; since 1936 they have not been taxable at all on any capital gains. (*Cf. De Nobili Cigar Co.*, 1 T. C. 673 at 678, first paragraph.)

The Solicitor General will presumably concede that a nonresident alien not engaged in business in the United States is not taxable on a gain realized from a distribution in liquidation even if the exchange of his shares for assets actually takes place in the United States. But this is so because a distribution in liquidation is not a "dividend" within Sections 211(a), 143(b), 119(a)(2), or 115(a).

How, then, can the mere fact that the distributee is a nonresident alien engaged in business in the United States alter the *character* of a distribution in liquidation and convert it into a "dividend"? Such distributions are not "dividends" to citizens. (*Cf. Helvering v. Credit Alliance Corp.*, 316 U. S. 107 at 110.)

The Tax Court entered final judgment that petitioner owed the exact *tax* deficiency asserted in the deficiency notice. The Commissioner, however, had also assessed and collected interest in the amount of $132,853.74, calculated from March 15, 1938 [R. 63]—as interest would be calculated in the case of a citizen. Having found that petitioner was a nonresident alien, against whom interest began only on June 15, 1938 (Sections 292, 218 and 56), the Tax Court gave judgment in favor of petitioner for "an overpayment in interest on jeopardy assessment of $7,321.08," which was the amount of interest attributable to the 92 days beginning March 15, 1938 [R. 79].

The Circuit Court of Appeals properly took the view "that the deficiency seems to have been based on the August exchange" [R. 384]. But as the issues framed by the pleadings went only to the question whether the undisputed "recognized" gain of August 6 was taxable to petitioner or was excluded from gross income under Section 212(a), the court, in line with the last paragraph of *Helvering v. Cement Investors, Inc.*, 316 U. S. 527 at 535, should have refused to consider the December exchange even if Section 112(i) had not already made that exchange irrelevant to petitioner's tax liability. The framing of issues by written pleadings timely filed is of the essence of fair hearings. (*Cf. Dobson v. Commissioner*, 320 U. S. at 498.) That is recognized by the Tax Court's Rules 6, 14, 16, 17, 18 and 32, 26 U. S. C. A. "§3600 to End", p. 604, which rules are usually enforced. (*Cf. California Brewing Association*, 43 B. T. A. 721 at 725; *Commissioner v. Sussman*, 102 F. (2d) 919 at 922 (C. C. A.-2, 1939).) The petitioner won all three of the only issues framed by the *written* pleadings and yet stands defeated unless this Court exercises its discretionary powers.

With deference it is submitted that the opinions below contain as much "bad law" as it is possible to find in a single case. Both opinions show that the courts viewed it as a "hard case." That view ignores the fundamental elements of the *right* of expatriation—a right indispensable to the human freedom which this Court is ever zealous to defend. Aside from the right of the petitioner to have a corporation, organized under the laws of his own sovereign, own shares of United States corporations —and the undisputed findings show that Colonial owned shares of other corporations than Hay, Ltd. [R. 60]—Sections 212(a) and 119(e) presuppose that a nonresident alien has a *right* to consummate, tax-free, outside the United States, sales or exchanges of *personal* property that might be taxable if made within the United States.

Reasons Relied on for the Allowance of the Writ.

1. Never before has the Commissioner contended that he has the power to ignore a *gain*. (*Cf. Burnet v. Commonwealth Improvement Co.*, 287 U. S. 415.) Never before has he contended for the power to ignore a specific legislative command to "recognize" a *gain*. (*Cf. Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913.)

These contentions involve important questions of federal law which have not been but should be settled by this Court, especially when the claimed administrative power is desired only to defeat the rights of a nonresident and friendly alien specifically declared by Section 212(a) and probably having their roots in the limitations of the taxing power of Congress. (*Cf. United States v. Belmont*, 301 U. S. 324 at 332.)

2. The "no actual profit" concept introduced into the body of tax law by the opinion of the Circuit Court of Appeals [R. 378-379] is in direct conflict with the decision of the Second Circuit in *Insurance & Title Guarantee Co. v. Commissioner*, 36 F. (2d) 842, cited with approval in note 3 of the opinion of this Court in *Helvering v. Cement Investors, Inc.*, 316 U. S. 527, with the reasoning of which such concept is also completely out of harmony.

3. In affirming the decision of the Tax Court based upon a transaction of exchange entirely different from that upon which the deficiency was determined and assessed, and not within the issues as framed by the Commissioner (*cf.* last paragraph of *Helvering v. Cement Investors, Inc.*, 316 U. S. 527 at 535), the Circuit Court of Appeals so far departed from the accepted and usual

course of judicial proceedings, and so far sanctioned such a departure by the Tax Court, as to call for an exercise of this Court's power of supervision. In allowing the Commissioner to add "another string to his bow" (*cf.* last paragraph of *Helvering v. Wood,* 309 U. S. 344 at 349—and see R. 132), which he declined to plead and which was—factually and legally—diametrically contradictory of the basis of his deficiency determination, to which basis the Commissioner adhered throughout the trial, the Tax Court allowed an administrative official to act in a manner contrary to "the cherished judicial tradition embodying the basic concepts of fair play." (*Morgan v. United States,* 304 U. S. 1 at 22.)

4. In holding that a distribution in complete liquidation is a "dividend" within Section 119(a)(2), and not an "exchange" within Section 119(a)(6), (e) and (f)—as it is under Section 115(c)—the courts below have inescapably held that *all* nonresident aliens, including those taxable under Section 211(a), are taxable on distributions in liquidation. Section 211(a) aliens, ever since the enactment of the Revenue Act of 1936, have been taxable *only* on "fixed or determinable annual or periodical" income [R. 338-339] from "sources within the United States, determined under the provisions of section 119." (See Art. 211-7 and the cross-reference to Art. 143-2.) To protect the revenue in the case of nonresident aliens of all classes, all payors of "fixed or determinable" income, including "dividends," are required to withhold from the payment or distribution a tax at a specified rate. Section 143(b) (*infra,* p. 22); first sentence of Art. 143-1 (*infra,* p. 25). But the Treasury, beginning with Regulations 94 (1936) and continu-

ing to the present time, has consistently provided that "The tax must be withheld at the source from the gross amount of any distribution made by a corporation, *other than* * * * a distribution in partial or complete liquidation * * *." (Next to last sentence of first paragraph of Art. 143-1 (*infra*, p. 26).) This is the equivalent of saying that a distribution in liquidation is *not* a "dividend," which is completely consistent with the long-settled statutory concept of Section 115(c), that a distribution in liquidation involves an exchange. (*Cf. Hellmich v. Hellman*, 276 U. S. 233.)

Unless this Court corrects the view of the courts below that a distribution in liquidation is a "dividend," it will be necessary, notwithstanding Art. 143-1, for all corporations making such distributions to withhold the tax therefrom. Thus, Section 211(a) aliens, that is, those not engaged in business, will be subjected to a tax on the gross amount distributed to them (*cf. Neill*, 46 B. T. A. 197), even in cases where the cost of their shares surrendered is greater than the amount distributed and there is in fact no income.

The question on this branch of the case is, therefore, one of importance in the administration of the revenue acts which has not been but should be settled by this Court.[13]

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[13]The current 1945 rate is 30%. Secs. 211(a) and 143(b), I.R.C.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition should be granted.

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February 14, 1945.

Certificate of Counsel.

The undersigned counsel of record hereby certifies that the foregoing petition is well founded and is not interposed for the purpose of delay.

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